ARBITRATION ADVISORY

97-03

FEE ARBITRATION ISSUES INVOLVING CONTINGENCY FEES

August 22, 1997

Points of view or opinions expressed in this document are those of the Committee on Mandatory Fee Arbitration. They have not been adopted or endorsed by the State Bar's Board of Governors and do not constitute the official position or policy of the State Bar of California.

INTRODUCTION

Arbitrations of fee disputes pursuant to Business & Professions Code section 6200 et seq.[1] involving contingency fees sometimes raise procedural as well as substantial issues which are unique to such situations. This Advisory addresses some of those issues.

WHEN THERE IS NO WRITTEN FEE AGREEMENT

Section 6147 requires a written fee agreement when an attorney undertakes to represent a client on a contingency fee basis. It also imposes certain requirements for the contents of the written agreement. Failure to comply with the statute renders the agreement voidable at the client's option (see Arbitrator Advisory 96-04, "Voidability of Fee Agreement). If the agreement is voided, the attorney is entitled to collect a "reasonable fee" (section 6147(b)).

Whether the failure to comply with section 6147 is due to the lack of a written fee agreement or due to the fact that the written fee agreement does not meet the requirements of the statute leads to the same consequence: At the client's option, whatever fee agreement that might have been reached is voided and the attorney is entitled to only the reasonable value of his or her services (*Spires v. American Bus Lines* (1984) 158 Cal.App.3d 211).

FEE DISPUTES BETWEEN A CLIENT AND AN ATTORNEY

[1] All statutory references are to the California Business & Professions Code.

The following hypotheticals highlight some of the issues that arise when a client and an attorney have a fee dispute under a contingency fee agreement:

Hypothetical 1: Client hired Attorney to prosecute his personal injury claim with a written fee agreement providing for a 1/3 contingency fee to the attorney. After Attorney rendered substantial services, Client discharged Attorney (or Attorney withdrew). While the Client's personal injury case is still unresolved, Attorney claims entitlement to fee.

Ripeness

May the arbitration proceed even though Client's underlying case is not yet over?

Discussion: The discharged Attorney is entitled to fees in *quantum meruit* (meaning a "reasonable fee") (*Fracasse v. Brent* (1972) 6 Cal.3d 784, 791). The amount of the "reasonable fee" cannot be determined until the contingency has occurred, i.e., the underlying case has been resolved, whether by trial, settlement or otherwise. Thus, if Client lost the underlying case and therefore never achieves any recovery, Attorney will not be entitled to receive any fee (*Fracasse, supra*, 6 Cal.3d at 792). Any section 6200 fee arbitration proceedings should be dismissed or held in abeyance pending resolution of Client's underlying case.

Withdrawn Attorney's Right to Fees

Is Attorney entitled to any fee if he withdrew from Client's representation without cause?

Discussion: An attorney who voluntarily withdrew without cause from representing a client is not entitled to any fee for the services performed (*Hensel v. Cohen* (1984) 155 Cal.App.3d 563; *Estate of Falco* (1987) 188 Cal.App.3d 1004, 1013). By way of example, none of the following constitutes cause justifying an attorney's withdrawal: a client's exercise of his or her right to reject a settlement offer, personality clash or even lack of cooperation; while mandatory withdrawal due to ethical mandates constitutes cause entitling the attorney to recover attorneys fees. The fact that the court granted an attorney's motion to withdraw does not in and of itself constitute cause for the purpose of giving the attorney a right to *quantum meruit* attorneys fees (*Estate of Falco, supra*).

Hypothetical 2: Client hired Attorney to prosecute his personal injury claim with a written fee agreement providing for a 1/3 contingency fee to the attorney. After Attorney rendered substantial services, Client discharged Attorney (or Attorney withdrew with cause). Thereafter, unrepresented by any attorney, Client settled the case with a net recovery of $100,000. Client initiated fee arbitration.

Attorney's Entitlement to Full Amount of Contingency Fee

Issue 1: Attorney claims entitlement to the entire 1/3 contingency. Client argues that since settlement was achieved without Attorney's representation, the fee award necessarily must be less than the full 1/3 contingency amount.

Discussion: Depending on the facts of each case, the arbitrator may determine that the reasonable value of Attorney's services is equal to the full 1/3 contingency amount (*Fracasse*, *supra*, 6 Cal.3d at 791; *Schneider v. Kaiser Foundation Hospitals* (1989) 215 Cal.App.3d 1311, 1316, citing *Fracasse*).

Issue 2: The retainer agreement contains a clause to the effect that Attorney may not be discharged without cause. Attorney claims that he was fired without cause, therefore entitling him to the full contract amount of 1/3 of the net recovery.

Discussion: A client has an absolute, unfettered right to discharge his/her attorney at any time, with or without cause. *Fracasse*, *supra*, 6 Cal.3d at 790-791. Thus, even if a written fee agreement provides that an attorney may not be discharged without cause, a client may safely do so without fear of incurring damages for breach of contract. Therefore, Attorney is only entitled to the "reasonable value" of his services.

Attorney's Claim to Hourly-Rate Based Fee Upon Discharge

Issue: The retainer agreement contains a provision to the effect that should Attorney be discharged without cause, Client is obligated to pay Attorney for his time spent at a specified hourly rate. Attorney claims that he was fired without cause. Attorney claims that he spent 300 hours and that, at his customary and usual hourly rate of $200 each hour, he is entitled to $60,000 in fees.

Discussion: There is scant authority addressing this issue. In *Spires*, *supra*, plaintiff was represented by a succession of attorneys, all on contingency. The Court held that, under *Fracasse*, when the contingency fee is insufficient to meet all attorneys fee claims, it should be distributed to each claimant in proportion to the reasonable value of their services. The total contingency fee was $1,400. One of the attorney's retainer agreement provided for fee to be paid on an hourly-rate basis in the event the attorney was discharged. This attorney initially filed a lien for $3,128.29 based on time expended at an agreed hourly rate of $60. However, the client's total recovery, $2,100, was less than this claim alone. The Court's opinion did not account for whether or how the attorney's initial claim of $3,128.29 was withdrawn or reduced, nor did it explain whether there was good cause causing the attorney in question to cease to be plaintiff's attorney.

In concluding that a discharged attorney is not entitled to receive any fee unless and until the client obtains recovery in the underlying lawsuit, the Supreme Court in *Fracasse*, *supra*, was concerned that to hold otherwise would place an improper burden on the client to pay his former attorney regardless of the outcome of the litigation, as "[t]he client may and often is very likely to be a person of limited means for whom the contingent fee arrangement offers the only realistic hope of establishing a legal claim." The Supreme Court added that the fact that the success of the litigation is no longer under the control of the discharged attorney "is insufficient to justify imposing a new and more onerous burden on the client."

However, *Fracasse* was a personal injury case, and the client in that case was an individual. The Court's concerns in *Fracasse* may yield to other considerations in a case, for instance, when a sophisticated business entity negotiates a contingency fee agreement for the prosecution or even defense of a business-related lawsuit. There are competing considerations, including freedom of contract principles and the concern

that such a provision may be an impermissible restraint on the client's absolute and unfettered right to change counsel. In any event, there is support for the argument that, in an appropriate case, notwithstanding a contractual provision that calls for the attorney being paid for time spent at a stated hourly rate, the payment cannot exceed one contingency fee.

The Committee recommends that, when faced with this issue, the arbitrator should give such a provision close scrutiny from the standpoint of whether it passes the "conscionability" test of Rule 4-200 of the Rules of Professional Conduct. Some of the factors an arbitrator should consider in conducting such a scrutiny may include:

(a) Whether the case involves the kind of claims customarily handled on a contingency or hourly-rate basis (e.g., prosecution of a personal-injury claim arising from an automobile accident, or an employee's claim for wrongful termination of employment or discriminatory employment practices versus the pressing of a breach of contract claim by a large, established business);

(b) the sophistication of the client;

(c) whether the subject of the representation is personal/family/household-related, or commercial;

(d) whether there was cause for the attorney's discharge/withdrawal;

(e) the provision's chilling effect or its potential for being punitive upon the client's exercise of the right to terminate counsel;

(f) the weight of the "contingency factor" (discussed *infra*);

(g) the inherent reasonableness of a fee based on the time spent multiplied by the stated hourly rate, viewed at the time the agreement was made;

(h) whether the provision is adhesive,

(i) whether the attorney customarily receives the stated hourly rate for similar services rendered;

(j) whether the attorney maintained detailed records of time spent;

(k) whether the client received periodic statements with sufficient descriptions of the services rendered.

Are All Successive Attorneys Necessary Parties to the Client's Fee Arbitration?

Hypothetical 3: Client hired Attorney A to prosecute his personal injury claim and signed a written fee agreement providing for a 1/3 contingency fee to the attorney. Thereafter, Client discharged Attorney A (or Attorney A withdrew with cause) and Client

signed a similar agreement with Attorney B, also providing for the attorney receiving 1/3 of the recovery. The case ultimately settled for a net recovery of $100,000. Attorney A claims a fee of $20,000. Client initiates arbitration, naming only Attorney A as respondent.

Issue: May the arbitration proceed in the absence of Attorney B?

Discussion: When more than one attorney lays claim to a contingency fee recovery, the total fee should be distributed among all attorneys entitled to share in it in proportion to the "reasonable value" of their services (*Cazares v. Saenz* (1989) 208 Cal.App.3d 279). This process necessarily entails a comparison of the reasonable values of the services of successive counsel. In the absence of Attorney B, there may not be a meaningful presentation of evidence going to the reasonable value of Attorney B's services, thereby skewing the process in favor of Attorney A. The parties should be informed that the participation of Attorney B is appropriate and/or there must be a sufficient showing in order for the arbitrator to be in a position to make a determination of the relative reasonable values of the services of the two attorneys.

The Committee suggests that Client be informed that the determination of the reasonable fee that may be awarded to Attorney A will necessarily entail a comparison of the relative efforts put in by all attorneys and that, in the absence of participation by all attorneys, the evidence presented may skew the results - and the results will not be binding on Attorney B. Thus, the Client is encouraged to include all attorneys as parties to the arbitration.

Contingency Fee Agreement Followed By Hourly Fee Agreement

Hypothetical 4: Client hired Attorney A to handle a personal injury claim and signed a written fee agreement, agreeing that the attorney was entitled to 1/3 of the recovery. Thereafter, Client discharged Attorney A (or Attorney A withdrew with cause) and Client hired Attorney B, agreeing to pay an hourly-rate based fee. The case then settled for a net recovery of $100,000. Attorney B was paid for his hourly-rate based fee. The Client, however, disputes Attorney A's claim for fee.

Issue: Is Attorney A's fee recovery limited to (a) 1/3 of the recovery, or (b) 1/3 of the fee recovery less the fee paid to Attorney B?

Discussion: This is likely to be a fact-intensive inquiry. If Attorney A already worked the case up to a point where a good settlement/judgment is likely, the attorney may be entitled to the full 1/3 contingency fee (*Fracasse, supra*, 6 Cal.3d at 791). Thus, for example, if Attorney A obtained a settlement offer of, say, $300,000, which Client rejected, and the case ultimately settled for or was tried to a judgment of the same amount, $300,000, depending on how other factors are resolved (e.g., the conduct of the Client, the conduct of Attorney B), Attorney A may be entitled to the full 1/3 contingency fee, with the Client having to bear the burden of the hourly-rate based fee to Attorney B (assuming Client does not challenge the reasonableness of Attorney B's fee). On the other hand, if the contribution of Attorney A was not a determinative factor in the favorable outcome (evidenced, for example, by the fact that Attorney B obtained a $1,000,000 settlement or judgment), the reasonable fee award to Attorney A may well be limited to the contract price less the fee paid to Attorney B, or some other

measure of the reasonable value of Attorney B's services - see below[2]. The basic principle which should guide the arbitrator in arriving at an award is that Attorneys A and B must share the fee in proportion to the reasonable values of their respective services. Under this principle, whether Attorney B was paid an hourly fee, a contingency fee or a fixed fee does not change the analysis.

Reasonableness of the Contract Price

Hypothetical 5: Client hired Attorney to prosecute his personal injury claim, with a written fee agreement providing for a 1/3 contingency fee to the attorney. The case settled for a substantial amount shortly after Attorney filed a complaint. Attorney claims entitlement to the full amount of the contingency fee which, when divided by the hours that Attorney spent on the matter, translates into an hourly rate of $1,000 per hour. Client disputes this, claiming that Attorney is only entitled to a reasonable fee calculated at an hourly rate of $200 hour charged by other attorneys of similar background, experience and reputation.

Issue: Is Attorney entitled to the contract price of the 1/3 contingency even though that exceeds the "reasonable value" of the services rendered?

Discussion: Courts have consistently taken the position that, with a fee agreement that is freely bargained for and does not provide for an unconscionable fee, the contract price is the best indicator of the reasonable value of the attorney's services. Therefore, there is no inherent reason why an attorney who is otherwise entitled to it may not receive compensation which exceeds the "reasonable value" of his or her services determined without reference to the contract price (see *Franklin v. Appel* (1992) 8 Cal.App. 4th 875, where a fee award which was the equivalent of $1,184 per hour was affirmed on appeal).

COMPETING CLAIMS BY SUCCESSIVE COUNSEL

It is not uncommon to see "three-way" fee disputes involving the client and two or more attorneys who represented the client on a contingency-fee basis at different stages of the underlying matter, or a fee dispute involving only the successive attorneys, but not the client. Some examples Follow:

Arbitrations Involving Attorneys, Not Client

Hypothetical 6: Client hired Attorney A to handle a personal injury claim and signed a written fee agreement, agreeing that the attorney was entitled to 1/3 of the recovery. Thereafter, Client discharged Attorney A (or Attorney A withdrew with cause) and Client signed a similar agreement with Attorney B, also providing for the attorney receiving 1/3 of the recovery. The case ultimately settled for a net recovery of $100,000. Attorney A

---

[2] Attorney A's fee may also be *limited* to 1/3 of the $200,000 settlement offer that was on the table before Attorney A withdrew or was discharged.

claims entitlement to $30,000, leaving only $3,333 for Attorney B. Attorney B disputes Attorney A's claim. Both attorneys agree that the total fee is $33,333. Client agrees that $33,333 should be paid, and takes no position, as between the two attorneys, who gets what portion of this $33,333.

Issue: Is there jurisdiction under section 6200 et seq. to accept arbitration of the competing claims of Attorney A and Attorney B?

Discussion: Although there is nothing in section 6200 et seq. specifically limiting fee arbitrations thereunder to disputes between a client and the client's attorney, such limitation is clear from the overall statutory scheme. Thus, section 6200(c) provides that "unless the client has agreed in writing to arbitration under this article ... arbitration under this article shall be voluntary for a client and shall be mandatory for an attorney if commenced by a client."[3] For this reason, the fee arbitration program under the auspices of section 6200 et seq. does not handle conflicting claims by a client's successive attorneys to a contingency fee when the client does not dispute that the contingency fee is payable to the attorneys as a group.[4] Some local bar programs, however, elect to provide arbitration services to arbitrate disputes wherein two or more attorneys are claiming entitlement to the same fee, without the client being a party to the arbitration.

Arbitrations Involving All Attorneys and Client

Hypothetical 7: Client hired Attorney A to handle a personal injury claim and signed a written fee agreement, agreeing that the attorney was entitled to 1/3 of the recovery. Thereafter, Client discharged Attorney A (or Attorney A withdrew with cause) and Client signed a similar agreement with Attorney B, also providing for the attorney receiving 1/3 of the recovery. The case ultimately settled for a net recovery of $100,000. Attorney A and Attorney B each claims entitlement to $33,333. Arbitration is initiated with the bar association with the Client and both attorneys as parties.

Issue 1: Is there subject matter jurisdiction if Client agrees that $33,333 should be paid to the attorneys, and does not care how this total is divided between Attorney A and Attorney B?

Discussion: Yes, since Client is nominally a party to the arbitration by reason of either being the one who petitioned for arbitration, or if the arbitration was initiated by one of the attorneys, consented to arbitration.

Issue 2: What if the Client, while agreeing that $33,333 of the recovery should

---

[3] In National Union Fire Ins. Co. v. Stites Prof. Law Corp. (1991) 235 Cal.App.3d 1718, the Court held that there is no subject matter jurisdiction under §6200 et seq. to arbitrate a fee dispute between an insurer and the insured's attorney because §6200 et seq. governs fee disputes between attorneys and their clients only, and the insurer, though obligated under the insurance policy to indemnify the insured for its legal expenses, was not the attorney's client.

[4] There is jurisdiction to arbitrate a client's claim that one or more of the attorneys who handled the client's case is not entitled to the portion of the overall contingency fee such attorney(s) claims entitlement to. This is discussed *infra*.

be paid as attorneys fees, claims that Attorney A is not entitled to any of this, and that Attorney B is entitled to the entire $33,333?

Discussion: There is subject matter jurisdiction since there is a fee dispute at least as between Client and Attorney A. The arbitrator should first determine if Attorney A is entitled to any fee and, if so, should divide the $33,333 between Attorney A and Attorney B in accordance with the relative reasonable values of their services (see *infra*).

Issue 3: What happens if the arbitrator finds that neither of the written fee agreements complies with section 6147 and Client, electing to void the agreements, claims that no attorneys fee should be paid to either attorney because, for example, Client settled the claim on his or her own?

Discussion: The arbitrator should determine the reasonable fee each attorney may be entitled to, provided that the total of the fees does not exceed $33,333, the contract price).[5]

Successive Fee Agreements With Different Contingency Rates

Hypothetical 8: Client hired Attorney A to handle a personal injury claim and signed a written fee agreement, agreeing that the attorney was entitled to 1/3 of the recovery. Thereafter, Client discharged Attorney A (or Attorney A withdrew with cause) and Client signed a similar agreement with Attorney B, except that the contingency fee to Attorney B was 1/4. The case ultimately settled for a net recovery of $100,000. Attorney A and Attorney B each claims entitlement to their respective contingencies. Arbitration is initiated with the bar association with the Client and both attorneys as parties.

Issue: What is the ceiling on the amount of attorneys fee that may be awarded to the attorneys - 1/3 of the recovery, 1/4 of the recovery, or 7/12 of the recovery?

Discussion: According to *Cazares*, *supra*, the reasonable fee award to each attorney may not exceed the contract price. Thus, Attorney A may not recover more than the 1/3 contingency fee specified in his fee agreement, and the ceiling on Attorney B's reasonable fee is 1/4 of the recovery. The combined total of the reasonable fee award to both attorneys should not exceed the greater of the two contingency fees as the attorneys in this case should not fare better than the attorneys in *Cazares*, all of whom had the same contingency percentage and the Court limited the total of their fee award to this contingency percentage.

DETERMINATION OF "REASONABLE VALUE" IN DIVIDING A CONTINGENCY FEE AMONG SUCCESSIVE ATTORNEYS

While some cases appear to define "reasonable value" by the time spent by

---

[5] The contract price (i.e., the 1/3 contingency amount in the hypothetical) is a ceiling which may not be exceeded even if the "reasonable fee" is more than the contingency fee. (*Cazares*, *supra*, 208 Cal.App.3d at 289.)

each attorney (*Spires*, *supra*), this approach is often "overly narrow" (*Cazares*, *supra*, 208 Cal.App.3d at 287).

As suggested by *Cazares*, *supra*, the determination of a "reasonable value" for the purpose of distributing a fixed amount of fees among more than one attorney claiming entitlement to the fees is a two step process: (1) determine the "reasonable value" of each attorney's work by multiplying the hourly rate (adjusted if appropriate) by the number of hours expended (also adjusted when appropriate), and (2) adjusting the "reasonable value" of each attorney's services by the "contingency factor" and the "time delay factor" in order to arrive at the *relative* "reasonable values" for the purpose of allocating the total fee.

(1) Determining Individual "Reasonable Value" - Product of Adjusted Hourly Rate and Adjusted Hours Spent. The determination of "reasonable value" starts with the number of hours spent by the attorney. This number is then "evaluated in light of how long it would have taken other attorney's to perform the same tasks." "The lawyer's customary hourly rate can be evaluated by comparison to the rate charged by others in the legal community with similar experience" (*Cazares*, *supra*, 208 Cal.App. 3d at 287). The product of these two yields the reasonable value of the work completed, subject to the further adjustments in the next paragraph for the purpose of allocating the total fee.

(2) Determining Relative "Reasonable Value" - Adjusting for Contingency and Time Delay. The individual reasonable values are then adjusted by: (i) whether the attorney's time was spent early on in the case, when the "contingency risk" was higher, or close to resolution of the case, when there may be virtually no "contingency risk", and (ii) the expected wait between the rendition of services by the attorney, and the receipt of compensation.

Having performed these evaluations and arrived at the relative "reasonable values" of the services rendered by the attorneys competing for the total fee, the allocation of the fee is a matter of arithmetic: each fee claimant is entitled to a fraction of the total fee the numerator of which is the relative reasonable value of the attorney's work on the case and the denominator of which is the aggregate of the relative reasonable values of all attorneys who worked on the case and are claiming a portion of the total fee.

CONCLUSION

There are endless possible permutations of the fee dispute scenarios described in the above hypotheticals. This Advisory obviously cannot address all of the issues that may arise. Each dispute must be evaluated on its own merits and reasonable judgment must be exercised. By studying the principles expressed in some of the leading cases and discussed in this Advisory, arbitrators should be better equipped to make case-specific determinations that are consistent with legal precedents and achieve substantial justice for the parties involved.